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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

Nos. 82-1244 and 82-1309

CITYTRUST and CITYTRUST BANCORP, INC.,
Petitioners,

v.

ATHALIE DORIS JOY,
Respondent.

and

ROBERT C. BALDWIN, Et. Al.,
Petitioners,

v.

ATHALIE DORIS JOY,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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SUMMARY OF ARGUMENT

In accordance with the rule of *Burks v. Lasker*, 441 U.S. 471 (1979), the Court of Appeals looked to Connecticut law to determine whether the Court was bound by the decision of the Special Litigation Committee to dismiss the present action. Without a Connecticut case or statute directly on point, the Court of Appeals reviewed the body of Connecticut cases and statutes relevant to the issue. Gleaning from these authorities the traditional approach taken by Connecticut's judiciary and legislature requiring court review of the fairness of corporate actions personally benefitting directors (conflict of interest transactions), the Court of Appeals determined that the Connecticut Supreme Court would require independent judicial scrutiny of the Committee's recommendation.

The decision of the Court of Appeals does not conflict with the decision of any other Court of Appeals since no other court has considered Connecticut law.

The Court of Appeals reversed the granting of summary judgment because the District Court erroneously construed Connecticut law and because the facts contained in the report of the Special Litigation Committee required denial of summary judgment.

INTRODUCTION—ISSUE OF STATE LAW

Both petitions in this case represent invitations to this Court to mold a common law for all states, starting with Connecticut. To do so would be to create a federal common law of corporations relating to special litigation committees' termination of shareholder's derivative actions.

This Court in *Burks v. Lasker*, 441 U.S. 471 (1979) decided that state law controlled the issue of termination of shareholder's derivative actions. The Court of Appeals in the case at bar was required and did turn to state law. It held:

> "We agree with Judge Eginton for the reasons stated in his opinion that the Special Litigation Committee may seek dismissal of both the state common law and federal claims *if* Connecticut law authorized it to do so." [emphasis supplied]

Corp. Petition, p. A-9[1]

COURT OF APPEALS APPLIED CONNECTICUT LAW

Applying Connecticut law, the Court of Appeals held that in Connecticut the "business judgment rule" does not apply to conflict of interest transactions (i.e. corporate decisions which personally benefit directors).

Corp. Petition, p. A16-A17.

Simply stated, the Court of Appeals majority opined that the corporations' dismissal of this six million dollar suit against directors confers a personal

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1. Plaintiff's brief answers two Petitions for Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

1. *Citytrust and Citytrust Bancorp. Inc., v. Joy*, 1/24/83. Docket Number 82-1244 (Corporations' Petition).

2. *Boldwin, et. al. v. Joy*, 2/4/83, Docket Number 82-1309 (Defendants' Petition).

benefit on these outside directors and therefore must under Connecticut law be termed a personal benefit or conflict of interest transaction; and that under Connecticut law a personal benefit transaction must pass the test of fairness.

Corp. Petition, p. A17, 21.

Rejecting the rationale of the dissent that a finding of committee independence and good faith overcomes the conflict and personal benefit inherent in the decision to dismiss shareholder litigation against fellow directors, the Court of Appeals stated:

> "The conflict of interest which renders the business judgment rule inapplicable in the case of directors who are defendants is hardly eliminated by the creation of a special litigation committee."

Corp. Petition, p. A-16

> ". . . . This view [the dissent] is a major departure from the traditional scrutiny courts have given to the underlying fairness of corporate decisions which benefit directors. Lattin, *Corporations* at 293; *see also Ferris v. Polycast Technology Corp.*, 180 Conn. 199, 208-09, 429 A.2d 850, 854 (1980) *and cases cited* therein." [emphasis supplied]

Corp. Petition, p. A-17.

Of the cases cited in *Ferris, supra*, the following stand for the proposition that the independence (not being personally involved or receiving personal benefits) of the officers or directors making the corporation's decision does not change the requirement under Connecticut law that the personal benefit transaction between corporation and director will not stand unless it is found by the court to be fair to the corporation.

Osborne v. Locke Steel Chain Co., 153 Conn. 527, 534, 535, 218 A.2d 526, 531 (1966)
Kloput v. Northrup, 131 Conn. 14, 20, 37 A.2d 700, 703 (1944)
Massoth v. Central Bus Corporation, 104 Conn. 683, 689, 134 A.236, 238 (1926)
Sisk v. Jordan Co., 94 Conn. 384, 390, 109 A.181, 183, 184 (1920)
Mallory v. Mallory Wheeler Co., 61 Conn. 131, 138, 139, 23 A.708, 710, 711 (1891)

Even a possibility of personal benefit to a director makes the corporate action voidable in Connecticut.

Mallory v. Mallory Wheeler Co., 61 Conn. 131, 139, 23 A. 708, 710, 711 (1891)
Kloput v. Northrup, 131 Conn. 14, 21, 37 A.2d 700, 703 (1944)
Perlman v. Feldman, 219 F.2d 176, 177 (2nd Cir. 1955)

The Court of Appeals followed this Connecticut law in coming to its conclusion that the court must determine fairness notwithstanding the independence of the Special Litigation Committee.

Corp. Petition, p. A-16, 17, 21.

The "cases cited therein" in *Ferris, supra* and referred to by the Court of Appeals above are the very same cases cited by the Plaintiff to the Court of Appeals in the Plaintiff's Brief and Reply Brief (App. 1a et. seq.) These cases, cited in *Ferris*, required the conclusion reached by the Court of Appeals, i.e. that the "business judgment rule" does not apply to a conflict of interest (personal benefit) transaction, and that such a transaction must be fair to the corporation. The Court must decide fairness.

The Court of Appeals properly rejected the "good faith" test enunciated as the law of New York in *Auerbach v. Bennett*, 47 N.Y.2d 619, 419 N.Y.S.2d 920, 393 N.E.2d 994 (1979) in favor of the Connecticut rule requiring that the Court find fairness in order to uphold a transaction between director and corporation. In so doing the Court of Appeals said of the New York test:

> "Because we believe that test would work a major transformation of Connecticut corporate law, we predict that Connecticut would not adopt it . . .
>
> We detect no signals that Connecticut law is moving away from the enforcement of directors and officers' traditional fiduciary obligations."
>
> Corp. Petition, p. A-19.

The Court of Appeals went on to consider Connecticut's conflict of interest statute, Conn. Gen. Stat. §33-323, which it printed in relevant part in footnote 10 of its decision (Corp. Petition, p. A-21). The Court of Appeals found §33-323 to be applicable and determined that the statutory requirement of fairness to the corporation was satisfied by the Court's determination of whether dismissal of the action benefits the corporation (Corp. Petition, p. A-21).

Thus the Defendants' assertion (Defendants' Petition, p. 4) that the Court of Appeals decision is founded "solely on one entirely irrelevant case [*Ferris, supra*] and two entirely irrelevant statutes" [§33-320 and §52-572(j)] is a bald misstatement of the Court of Appeals decision.

THE COURT OF APPEALS IS NOT REQUIRED TO DEFER TO THE DISTRICT COURT'S VIEW OF CONNECTICUT LAW

The policy of this Court is that it leaves the determination of state law to the lower courts.[2]

Burks v. Lasker, 441 U.S. 471, 477-478, 485 (1979)
Butner v. U.S., 440 U.S. 48, 58 (1979)
Bernhardt v. Polygraphic Co., 350 U.S. 198, 205 (1956) and concurring opinion of Justice Frankfurter, 350 U.S. 198, 209-212
Note, *Justice Frankfurter—The Erie Doctrine* 67 Yale L.J. 187, 217-218 (1957)

The Defendants' Petition, citing *Erie Railroad Co. v. Tompkins*, would have this Court believe that the Court of Appeals abrogated state law in favor of decisions of the federal courts which might be thought to comprise the "general law."

Def. Petition, p. 8.

The District Court had relied primarily on the law of other jurisdictions. It disregarded the language of Conn. Gen. Stat. §33-323 and Connecticut common law in favor of the rule enunciated by federal courts in other cases (i.e. that special litigation committees are to be afforded the latitude of business judgment in their decisions to terminate shareholder derivative

2. In fact Supreme Court Rule 17, which prior to 1980 was Rule 19, now entirely omits that portion of pre-1980 Sect. 19(b) which reads: "or conflict with applicable state or territorial law."

litigation, based only upon a finding of good faith).[3] In so doing the District Court violated the *Erie* mandate. The Court of Appeals on the other hand carefully reviewed Connecticut case law, Connecticut statutes and treatises, all relating to corporate governance, and came to its conclusions by following the guidelines and indications contained in the body of Connecticut corporate law which is revealed in these decisions and statutes.

Corp. Petition, p. A-17-21

In so doing the Court of Appeals fulfilled its proper appellate function in reviewing a District Court's interpretation of state law.

Town of East Troy v. Soo Line Railroad Company, 653 F.2d 1123, 1129 (7 Cir. 1980)
Huss v. Prudential Ins. Co. of America, 37 F. Supp. 364, 366 (D. Conn. 1941)
1A (Pt. 2) Moore, *Federal Practice* ¶0.309[2] (2nd ed. 1982)

The Court of Appeals was convinced that the District Court was wrong in its view of Connecticut law. This is apparent from a reading of its entire decision as well as its conclusions. Being convinced that the District Court was wrong, the Court of Appeals could hardly be justified in doing anything except reversing the District Court. No rule requires the Court of Appeals to state *in haec verbae* that the

3. "Moreover, to find these procedures infirm and voidable under the statute would place in jeopardy the concept of a litigation committee at a time when such committees have become widely accepted, useful tools for disposing of detrimental derivative actions." Def. Petition, p. B-15-16.

District Court decision was "clearly erroneous" in order to reverse same.

This Court may take judicial notice[4] of the fact that Judge Winter, who authored the majority opinion on behalf of the Court of Appeals, has been a member of the Connecticut bar since September 11, 1973, and that he was a Yale Law Professor prior to his appointment to the Court of Appeals.

NO CONFLICT WITH *BURKS*

The Corporations' Petition for Certiorari incorrectly represents the holding of this Court in *Burks v. Lasker,* 441 U.S. 471, 485 n. 15 (1979) on the issue of whether outside directors are truly disinterested. The corporations quote *Burks* in the following manner:

> "[w]hile lack of impartiality may or may not be true as a matter of fact in individual cases, it is not a conclusion of law . . . [emphasis added]
>
> Corps. Petition, p. 6, 7 quoting *Burks v. Lasker supra,* 441 U.S. at 485, n. 15 (1979)

Actually the *Burks* opinion construed only the Investment Company Act on this issue and not the general common law or the law of any of the states. This Court in *Burks,* fully quoted, held that:

> "while lack of impartiality may or may not be true as a matter of fact in individual cases, it is not a conclusion of law *required by the Investment Company Act.*" [emphasis added]
>
> *Burks v. Lasker,* 441 U.S. 471, 485 n. 15 (1979)

4. Superior Court New Haven County, Roll of Attorneys.

As fully stated the *Burks* quote is quite consistent with the policy of this Court *not* to decide matters of state law. As such this holding does not conflict with the decision of the Court of Appeals on Connecticut law.[5]

Moreover the Defendants' Petition (p. 6) has erroneously stated that this Court in *Burks v. Lasker* found "no basis in the Investment Company Act . . . *or anywhere else* for an inference that the conflict of interest experienced by a defendant director applied *by force of human nature* to a non-defendant director." [First emphasis added] However this Court looked only to the Investment Company Act *and nowhere else.*

Burks v. Lasker, 441 U.S. 471, 481-82, 486 (1979)

Indeed it taught in that opinion that the issue was to be determined by state law, on which it deferred to the Court of Appeals on remand.

Id. at 486.

NO CONFLICT BETWEEN CIRCUITS

The Corporations' petition incorrectly accuses the Court of Appeals of inconsistency with the Eighth, Ninth and Fifth Circuits (Corps. Petition, p. 10, 11). However the Ninth Circuit construed California law.[6]

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5. In fact the Court of Appeals made no finding that a committee of directors can *never* be independent under Connecticut law.

6. *Gaines v. Haughton,* 645 F.2d 761 (9th Cir. 1981), *cert. den.* 102 S. Ct. 1006 (1982); *Lewis v. Anderson,* 615 F.2d 778 (9th Cir. 1979), *cert. den.* 445 U.S. 868 (1980).

The Eighth Circuit erroneously (pre-Maldonado[7]) construed Delaware law.[8] The Fifth Circuit construed Texas law.[9] The decision at bar construed Connecticut law only. Other than the instant decision, no Circuit Court of Appeals has ever construed or declared Connecticut law on this issue. The conflict is between the law of different states, not between circuits.

PURPORTED DUE PROCESS ISSUE

The Corporations' petition, (p. 13) complains that the Court of Appeals took away the prerogative of the District Court to hold hearings and admit extrinsic evidence in order to determine the issue of fairness. The petitioners have had their day in court on these summary judgment proceedings. At the District Court level the plaintiff made an issue that the Court must determine fairness (Corp. Petition, p. B-14-17). Relevant Connecticut cases had been decided long before the defendant's Motion for Summary Judgment. These cases clearly presented the proposition that corporate action to the personal benefit of individual directors, when challenged, must be reviewed by the court for "fairness." See cases cited *supra*, pages 4-5.

Indeed *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. Sup. Ct. 1981) was decided three months before the District Court decision in the instant case; and *Maldonado* was briefed to the District Court by both parties and rejected by the District Court (Def. Peti-

7. *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. Sup. Ct. 1981).

8. *Abbey v. Control Data Corp.*, 603 F.2d 724 (8th Cir. 1979), *cert. den.* 444 U.S. 1017 (1980).

9. *Clark v. Lomas & Nettleton Financial Corp.*, 625 F.2d 49 (5th Cir. 1980), *cert. den.* 450 U.S. 1029 (1980).

tion, p. B-30, footnote 9). With the advent of *Maldonado* there were then two distinct lines of authority, one advocating the "business judgment rule," requiring "good faith and independence" as the only finding necessary to dismiss a shareholder's action, while the other line of authority requiring that the court determine what was in the best interest of (or fair to) the corporation. Still the corporations, relying on their vigorous albeit erroneous view of Connecticut law, opted not to present evidence on the merits beyond the Special Litigation Committee report. To do so would have weakened their claim that the District Court should not look at the merits or determine fairness. The petitioners' strategy failed because they misconceived the law.

Moreover, the Special Litigation Committee Report was rendered on behalf of the Corporations. The Corporations moved on it. The Report constituted an admission of the Corporations. The Court of Appeals accepted the facts contained in the Special Litigation Committee Report, and determined, based upon those admissions, that summary judgment was not warranted.[10] The Court of Appeals could draw conclusions from the facts as well as the District Court.

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10. Summary judgment proceedings are not a trial (F.R.C.P. 56). The plaintiff, based on the facts contained in the Special Litigation Committee Report, had presented sufficient evidence to preclude summary judgment.

CONCLUSION

As the present case involves only a question of Connecticut law as determined by the Court of Appeals, the Petitioners' requests for Writ of Certiorari should be denied.

Respectfully submitted,

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APPENDIX A—PLAINTIFF-APPELLANT'S BRIEF TO U.S. COURT OF APPEALS (pp. 19-24)

THE APPOINTMENT OF THE SPECIAL LITIGATION COMMITTEE BY THE DEFENDANT DIRECTORS AND THE DECISION OF THE SPECIAL LITIGATION COMMITTEE TO DISMISS THE ACTION AGAINST THE CORPORATION'S OWN DIRECTORS ARE BOTH ILLEGAL SELF-DEALING TRANSACTIONS UNDER CONNECTICUT CORPORATION LAW.

A. COMMON LAW, SELF-DEALING TRANSACTION

In Connecticut the "business judgment" rule does not apply to conflict of interest transactions between a director and his corporation. Regardless of the law of New York, or Michigan or California or Delaware or any other state in the United States, the Connecticut rule, both at common law and by statute, is that "business judgment" is not allowed in connection with a transaction between a director and the corporation. The proposed dismissal of the lawsuit is just such a transaction between corporation and director.

Zaubler v. Westview Hills Inc. 148 Conn. 540, 544, 545; 172 A. 2d 604, 606 (1961)

B. COMMON LAW, VOIDABLE

If a director of a corporation negotiates a contract *with himself,* that contract is voidable regardless of the fairness or unfairness of the contract.

Mallory v. Mallory Wheeler Co., 61 Conn. 131, 139, 23A. 708, 710, 711 (1891)

Massoth v. Central Bus Corporation 104 Conn. 683, 689, 134 A.236, 238 (1926)

If the interested director's vote is necessary to effectuate the transaction, it is voidable regardless of whether it is fair or unfair.

Kloput v. Northrup 131 Conn. 14, 20, 21, 37A.2d 700, 703 (1944)

Cathedral Estates v. Taft Realty Corporation 228 F.2d 85, 87 (2nd Cir. 1955)

Where the corporation, acting through *others*, enters into a contract with a director, it may be upheld only if the transaction is entirely fair to the corporation.

Klopot v. Northrup 131 Conn. 14, 20, 37 A.2d 700, 703 (1944)

"Where a director of a corporation enters into a transaction with it which will inure to his individual profit, we have held that he had the burden of proving that the transaction is entirely fair . . ."

Ibid.

". . . if he deals with it as an individual, not himself participating in the transaction on behalf of the corporation, the burden rests upon him to show the transaction was entirely fair . . ."

Massoth v. Central Bus Corporation 104 Conn. 683, 689, 134 A. 236, 238 (1926)

"His contracts and dealings with the corporation are not void, but are voidable unless the transaction be open, in good faith, fair and fully understood. Equity will scrutinize the dealing between the fiduciary and his *cestui que trust* with jealous care, and it will set aside the transaction with the utmost freedom upon

the least appearance of unfairness. Neither good intention or lack of fraud will avail to sustain the transaction.

But our decisions, and those of most of our States, go further and place upon the fiduciary whenever the transaction with his *cestui que trust* is before a court, the burden of affirmatively showing that the transaction was entirely fair, made in good faith, for an adequate consideration and upon a full understanding."

Sisk v. Jordan Co. 94 Conn. 384, 390, 109 A. 181, 183, 184 (1920)

The corporation's decision and move to dismiss the outside directors as defendants in the case is a self-dealing transaction. In *Zaubler v. West View Hills, Inc.*, 148 Conn. 540, 545, 172 A.2d 604, 606 (1961) the Connecticut Supreme Court determined that a corporation's decision to withdraw a lawsuit against the corporation's directors was just such a self-dealing transaction.

Even if the decision to withdraw is made in good faith, it is a self-dealing transaction because it involves a director of the corporation, and therefore the business judgment rule does not apply. The parties seeking to effectuate the transaction have the burden of proving to the Court, after a full trial, that the transaction is fair to the corporation.

Klopot v. Northrup 131 Conn. 14, 20, 37 A.2d 700, 703 (1944)

C. THE APPOINTMENT OF THE SPECIAL LITIGATION COMMITTEE WAS ITSELF AN ILLEGAL SELF-DEALING TRANSACTION

The corporation's by-laws (R. 278) and the Connecticut statute (§33-318), which permit a corporation to

appoint a committee and permit a committee to exercise the powers of the Board of Directors, do not control this case. Neither this statute, nor this by-law covers self-dealing transactions, nor do they nullify the rule in *Mallory, infra* or the Connecticut conflict statute, §33-323 *infra*.

The appointment of the Special Litigation Committee was made by the Board of Directors, a majority of whom, as defendants, had a clear and direct personal interest in the outcome of the Special Litigation Committee asssignment (App. 391-393, 344, 347). Not only would they personally benefit from a dismissal of the action against themselves, but indeed *that was the purpose of their appointment of this committee.* (App. 326-329).

Under Connecticut law a transaction is a self-dealing one if there is even a possibility of personal benefit to the director.

Mallory v. Mallory Wheeler Co. 61 Conn. 131, 138, 139, 23 A. 708, 710, 711 (1891)

"The basis of these rules is that the benefit which may inure to the director personally, or to others having interests adverse to those of the corporation, affords ground for *suspicion* that he has not given to the corporation he represents and its stockholders the undivided loyalty which he owes to them." [Emphasis added].

Klopot v. Northrup 131 Conn. 14, 21, 37 A.2d 700, 703 (1944)

There need not be a certainty of conflicting interests, but only a possibility in order to warrant voiding the transaction.

Perlman v. Feldman 219 F.2d 176, 177 (2nd Cir. 1955)

The vote appointing the special litigation committee may not be considered as separate and apart from the hoped-for action of the Special Litigation Committee. The Connecticut Supreme Court said in *Mallory v. Mallory Wheeler Co.*, 61 Conn. 131, 136, 23 A.708, 710, 711 (1891):

> "The contract of renewal must of course be considered in connection with the vote of the directors appointing an agent to make the renewal. The contract depends on that vote. The vote appointing the agent to make the contract and the making of the contract are the successive steps in one transaction. The latter cannot be valid if the former is invalid . . . It is not necessary to suppose that there was any formal agreement beforehand between the three directors interested that these three votes should all be passed. It is altogether likely that there was not such agreement. But the votes were all before the directors' meeting at the same time. These three directors were all present. They were each interested in the common object to be attained by their passage. No one of these votes could be passed without the affirmative voice of one of these directors."
>
> *Ibid.*

Of the sixteen directors who voted on August 15, 1979 to appoint the special litigation committee, thirteen were interested defendant directors. (App. 344, 347). A quorum of ten *independent* directors was required for a legal vote. (App. 392, 393; R. 278 Doc. 48c). Therefore at common law the action of the Special Litigation Committee is voidable for each of the following reasons:

1. Regardless of fairness or unfairness, the vote establishing the committee was voidable both because:

(a) The votes of the interested directors were necessary to effectuate the appointment (*Klopot, Cathedral Estates*)[6], and;

(b) This vote itself was a step by which the directors were engaging in a transaction with themselves (*Mallory*)[7].

2. The defendants have failed to establish their burden of proving to the Court that the decision of the Special Litigation Committee was entirely fair to the corporation. No hearing was held on this issue. The District Court entered summary judgment without discovery, without a trial on fairness, and without a decision on fairness.

D. CONFLICT OF INTEREST STATUTE—SECTION 33-323

The establishment of the committee *and* its decision, each being voidable at common law, *each* must fall unless they qualify under the corporation statute treating conflicts of interest.

Section 33-323, Connecticut General Statutes, says:

> §33-323 Corporate Transaction With *Directors and Others*
>
> (a) A . . . transaction between a corporation and a director thereof . . . shall not be voidable . . . if: (1) Such . . . interest is fully disclosed, and the . . . transaction is not unfair as to the corporation and is authorized by (i)

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6. *Klopot v. Northrup* 131 Conn. 14, 20, 21, 37A.2d 700, 703 (1944 *Cathedral Estates v. Taft Realty Corporation* 228 F.2d 85, 87 (2nd Cir. 1955)

7. *Mallory v. Mallory Wheeler Co.* 61 Conn. 131, 138, 139, 23 A. 708, 710, 711 (1891).

directors or other persons who have no substantial interest in such contract or transaction in such a manner as to be effective without the vote, assent or presence of the director concerned, or (ii) the written consent of all of the directors who have no substantial interest in such contract or transaction, whether or not such directors constitute a quorum of the board of directors; . . ."

In essence this statute provides that a self-dealing transaction is not voidable if it is:

(1) not unfair as to the corporation, *and*
(2) either authorized without the vote of the interested directors, or authorized by the written consent of all the directors who have no interest in the transaction.

APPENDIX B—APPELLANT'S REPLY BRIEF—United States Court of Appeals for the Second Circuit, Pages 1-4. *Joy v. Connecticut Financial Services Corp. and Citytrust* No. 81-7729.

ARGUMENT

BUSINESS JUDGMENT v. CONFLICT OF INTEREST

The business judgment rule is not a new development in Connecticut law. Its existence dates back at least to *Pratt v. Pratt, Reid & Co.*, 33 Conn. 446 (1866).

However THE BUSINESS JUDGMENT RULE DOES NOT APPLY IN CONFLICT OF INTEREST SITUATIONS. The business judgment rule has always been subject to Connecticut's strict conflict of interest rules.

Osborne v. Locke Steel Chain Co. 153 Conn. 527, 534, 535 (1966)

Even if the transaction in question has been negotiated by others on behalf of the corporation, the conflict of interest transaction between a corporation and its officer or director is voidable unless proven fair.

Ibid.

The defendants seem to confuse the conflict of interest rules invoked by plaintiff. The plaintiff attacks the Special Litigation Committee on two conflict of interest grounds:

a) The formation of the committee was illegal. (Plaintiff Appellant's Brief, pgs. 21-26).

b) The decision of the committee was illegal.

At common law in Connecticut there are two distinct rules relating to self-dealing:

a) If the actual self-dealing negotiations are carried on by the interested officer or director on behalf of the corporation (in other words if he *negotiates with himself*) the transaction is voidable without regard to fairness.

Mallory v. Mallory Wheeler Co. 61 Conn. 131, 139, 23A.708, 710, 711 (1891)

Massoth v. Central Bus Corporation 104 Conn. 683, 689, 134A.236, 238 (1926)

The individual defendants cite (page 18 of their brief) cases from New York, New Jersey and Delaware to the effect that a possibility of personal benefit does not make a transaction self-dealing. These decisions are directly contradictory to Connecticut common law.

Mallory, supra at 138, 139

Klopot v. Northrup 131 Conn. 14, 21, 37A.2d 700 (1944)

Perlman v. Feldman 219 F.2d 176, 177 (2nd Cir. 1955)

b) A transaction between director and corporation, if negotiated on behalf of the corporation by independent personnel, is nevertheless a self-dealing transaction. As such it is voidable, the test being whether the transaction is fair to the corporation.

Mallory, supra

Massoth, supra

Obsorne v. Locke Steel Chain Co. 153 Conn. 527, 534, 535; 218 A.2d 526 (1966)

The proposed termination of the lawsuit as to the outside directors, even if voted by disinterested directors, constitutes a self-dealing, conflict of interest transaction because it is a transaction between a corporation and its directors. As such it must pass the test of fairness at common law.

The defendants (both corporate and individual) claim throughout their briefs that a good faith deci-

sion by independent directors is sufficient to preclude judicial inquiry into the fairness of the questioned transaction. Their position is directly contradictory to the holdings of the Connecticut Supreme Court as exemplified in *Sisk v. Jordan*, 94 Conn. 384, 390; 109A. 181, 183, 184 (1920), where the Court ruled that bona fides is not enough to validate a conflict of interest transaction:

> "Neither good intention nor lack of fraud will avail to sustain the transaction."
>
> *Ibid.*

The transaction, under Connecticut law, must be found to be fair to the corporation, else it fails.

Id. at 388-390

The conflict of interest statute §33-323 (the safe haven) contemplates that in the conflict situation the disinterested directors may consider and approve the transaction (i.e. approval by disinterested majority of directors under §33-323a(1)(i), or unanimous written consent[1] of all disinterested directors (§33-323a(1)(ii)). Even if the statutory procedure is followed, Connecticut imposes an additional requirement, that the "... *transaction is not unfair as to the corporation* ..."

§33-323a(1) [emphasis added]

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1. Statutory approval by disinterested directors was not achieved in the case at bar because they were not a majority of the board, nor did all disinterested directors consent in writing to the termination (Baum, Stott and Dixon omitted). Therefore the burden again became that of the defendants to prove fairness under Section 33-323a(4).

The significance is this:

Even though the disinterested directors, necessarily exercising their best good faith judgment, may approve the transaction, that judgment is not enough. Fairness (or "not unfair") to the corporation is required by the express terms of the statute.